Investment

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International investors remain interested

The overall investment market is expected to heat up during the rest of 2019 as assets become more "affordable" and more properties become available.

- Six notable deals were concluded in Q1/2019 for a total consideration of around RMB27.6 billion, up by 66% year-on-year (YoY).
- Softening fundamentals and a need to generate cash flow have prompted some sellers to adjust pricing to expedite sales, resulting in a softening of cap rates.
- The first quarter saw a growing number of onshore/offshore bonds issued by developers. However, this was with the understanding that the majority of proceeds would be used to refinance/rollover existing debt, not to expand debt levels.
- International investors have remained active in purchasing assets in Shanghai with a focus on assets located in secondary business areas.
- The for-leasing residential market saw continuous growth as capital was injected in the sector.
- A consortium led by China Resources acquired a commercial land plot located in Jing'an for RMB5.8 billion with an AV of approximately RMB65,000 per sq m.
- Gross yields for recently-traded Grade A office assets increased by 0.1 of a percentage point (ppt) quarter-on-quarter (QoQ) to 4.9% in Q1/2019, while net yields were around 3.5-3.7%.

"Developers with limited financial resources sought development partners or offloaded development sites resulting in an increase in sales considerations for development sites."

JAMES MACDONALD, SAVILLS RESEARCH

Savills team

Please contact us for further information

RESEARCH

James Macdonald
Senior Director
China
+8621 6391 6688
james.macdonald@savills.com.cn

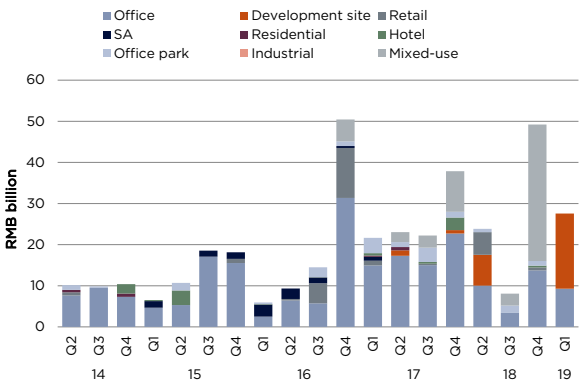
INVESTMENT

Nick Guan
Depty Head of Shanghai Investment
+8621 6391 6688
nick.guan@savills.com.cn

Simon Ha
Director
Shanghai
+8621 6391 6688
simon.ha@savills.com.cn

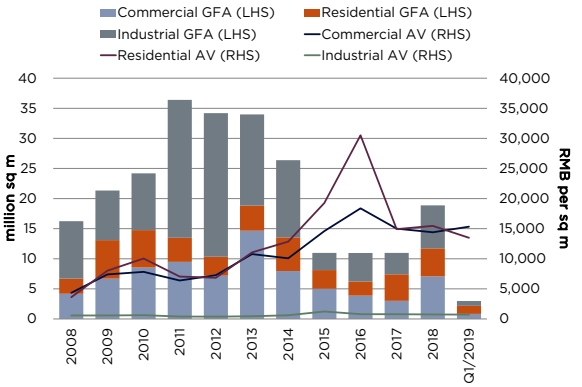
Jack Zhang
Director
Shanghai
+8621 6391 6688
jack.zhang@savills.com.cn

GRAPH 1: Shanghai Large-scale Real Estate Acquisitions, Q2/2014 to Q1/2019



Source Savills Research

GRAPH 2: Land Transaction Area And AVs, 2008 to Q1/2019



Source Savills Research

MARKET COMMENTARY

Shanghai's investment market saw an increase in total consideration to RMB27.6 billion, up by 66% YoY.

Continuing the trend from 2H/2018, international investors seized the opportunity to acquire assets in Shanghai in the first quarter, potentially at below market pricing. International investors seemed to be more interested in properties located in secondary areas such as the North Bund and old Huangpu submarkets as properties in decentralised areas tend to come with more risks, in terms of softening market fundamentals due to oversupply. The activeness of international buyers indicated their confidence in the potential of the Shanghai commercial real estate market as well as China's future economic growth. The average deal size was in the range of RMB2.5 billion to RMB4 billion.

Under the tight credit environment, some developers were forced to invite partners or sell big-scale development sites to ease credit stress since development sites require a large capital commitment. For example, Greenland purchased China Minsheng Investment's 50% stake in Dongjiadu development site for RMB12.1 billion. The transaction price was relatively low since China Minsheng Investment's original bid for the land parcel—made with a couple of other developers back in 2014—was approximately RMB25 billion. China Minsheng Investment was reported to have missed an RMB3 billion bond payment in January. That could explain why the developer offloaded one of its core assets at a discount.

Faced with slower economic growth, the Chinese government may have started to step back—but not necessarily turn away from—its campaign to financially de-risk the economy. In addition to the government's continuation of encouraging banks to finance small-and medium-sized enterprises, the beginning of 2019 saw a marked increase in developer bond issuances. However, under enormous repayment pressure in 2019, most of the companies issuing new bonds are expected to use the proceeds to rollover existing debt.

OFFICE MARKET

Three new projects were launched onto the core office market in Q1/2019, adding 104,700 sq m of new office space. They include Ruiming Tower, Foxconn Building and ITC Phase 2 (G2). Net take-up totalled 87,600 sq m in Q1/2019, up 24% YoY. For the third consecutive quarter, space in Prime Puxi was handed back to the market. Vacancy rates rose 0.1 of a ppt in Q1/2019 to 12.5%. Core market rents fell by 0.1% on an index basis in Q1/2019, currently averaging RMB9.01 per sq m per day.

Two new projects were handed over in the decentralised market in Q1/2019, adding 97,500 sq m of new office space. Similar to the core market, vacancy rates in decentralized areas increased by 1.9 ppts QoQ to 33.9% in Q1/2019, while rents fell 0.2% on an index basis to an average of RMB5.87 per sq m per day.

New supply in 2019 is likely to reach the same level as in 2018 for both core and decentralised markets (more than one million sq m for both areas). Oversupply has intensified competition for tenants, reducing pre-commitment levels and lengthening the required time for properties to stabilise their occupancy levels. This was evidenced by the relatively low pre-commitment rates seen in most of the projects launched in Q1/2019.

INVESTOR SENTIMENT

With their transparency and high liquidity, office properties remain highly sought-after assets for investors. Properties in core areas are receiving most of the investment attention as they are more insulated from downward rental pressure than those in decentralised areas. The market saw a correction in cap rates as some sellers started to adjust pricing to expedite sales, resulting in the softening of cap rates.

TABLE 1: Yields And Capital Values By Sector, Q1/2019

	GRADE A OFFICE	PRIME SHOPPING MALL	PRIME RETAIL STREET STORE	HIGH-END SERVICED APARTMENTS	HIGH-END STRATA APARTMENTS	5-STAR HOTEL	LOGISTICS
Gross reversionary	4.0-5.3%	5.5-6.5%	4.0-5.0%	4.0-5.0%	2.3-3.0%	5.5-7.5%	6.2-6.7%
NOI	3.0-4.0%	3.0-4.0%	2.0-3.5%	2.2-2.8%	2.0-2.5%	1.5-2.0%	4.5-5.5%
Approx. values (RMB per sq m)	50-90,000	60-100,000	150-250,000	55-70,000	100-200,000	40-50,000	6-8,000

Source Savills Research

DEALS

Three key deals were concluded in the office market in Q1/2019, including:

-Mitsui & Co acquired a portfolio of 45% stakes in both Huangpu Innovation Place and Ascendas Plaza from Ascendas-Singbridge for around RMB1.1 billion. Huangpu Innovation Place is located next to People's Square with a total aboveground GFA of 24,880 sq m. The building reopened in Nov. 2018 after renovation and upgrading. The reopened building also contains "the bridge", the coworking brand under Ascendas-Singbridge. In Q2/2015, AEW purchased Huangpu Innovation Place, which was named the Baolong Building at the time, from Blackstone for RMB940 million. Almost two years later, Ascendas-Singbridge Group acquired the building for RMB1.32 billion in Q1/2017.Ascendas Plaza is in Xujiahui with a total aboveground GFA of 44,000 sq m. Currently, Ascendas Plaza is under renovation and is planned to reopen in Q2/2019.

-Ant Finance and Alipay purchased Pudong Financial Square Building 2 from Lujiazui Properties for RMB2.35 billion for self-use. The building is in Zhuyuan with a total aboveground GFA of 49,000 sq m. However, Alibaba and Alipay booked the building back in 2012 and this price was negotiated back then.

-Keppel Capital acquired Yifang Tower from Yifang Group for RMB4.6 billion. Yifang Tower has office and retail GFA of 47,400 sq m and 26,900 sq m, respectively. Yifang Tower is located in North Bund and was launched in Q1/2017, but is currently vacant.

RETAIL MARKET

One new project, Orstar City in Putuo District, was launched onto the market in Q1/2019, adding 44,000 sq m of space to the market. Vacancy rates increased by 0.2 of a ppt QoQ to 6.8% in prime retail areas, and 1.1 ppts QoQ to 7.9% in non-prime retail areas. First-floor rents increased 0.3% in Q1/2019 to RMB27.7 per sq m per day.

Many traditional department stores in the city's prime retail areas are currently under renovation, helping to improve the retail environment of those locations and stimulate consumer spending.

INVESTOR SENTIMENT

Investors, especially international ones with expertise in revitalising underperforming retail properties, continue to search for upgrading and conversion opportunities. They typically look for retail assets located in core but not prime areas and, depending on their location and physical features, either renovate or convert the malls into co-working or for-leasing apartments. As a large amount of new shopping malls have launched onto the market over the years, the market has many outdated malls that could use some upgrading or conversion.

DEALS

In early April, Brookfield acquired three office buildings and a 79,296 sq m retail podium from Greenland for RMB10.57 bn. The project is located in Huangpu district, adjacent to World Expo Museum Metro Station (Line 13).

HOTEL MARKET

Hotels in first- and second-tier cities remain one of the most challenging real estate sectors in China. However, the fundamentals in the hotel market are expected to strengthen thanks to the growing tourism industry. Shanghai's five-star market ended February with Average Daily Rates (ADRs) of RMB886 and an average occupancy rate of 47.9%, while four-star hotels achieved ADRs of RMB508 and an average occupancy rate of 44.9%. The revenue per available room (RevPAR) in February for five-star hotels decreased by 3% YoY but for four-star hotels increased by 1.4% YoY.

INVESTOR SENTIMENT

Interest in purchasing hotels located in core areas for the intent of converting them into other asset classes—mostly for-leasing apartments—remains the main purpose for purchasing hotels in China. Meanwhile, some domestic developers are seeking opportunities to rebrand and revitalise hotel portfolios. Investors are starting to look at this submarket with more interest, thanks to the strengthening domestic tourism sector and rising travel demands.

RESIDENTIAL MARKET

Overall commodity residential supply fell 49.4% in Q1/2019 to 1.46 million sq m. First-hand commodity residential transaction volume fell 7.4% QoQ to 1.42 million, up 19.1% YoY. Average transaction prices fell by 7.8% QoQ to RMB56,500 per sq m.

No new serviced apartments launched onto the market in Q1/2019, though there were soft openings for new and rebranded projects scheduled to fully launch in Q2/2019. The citywide vacancy rate increased by 0.5 of a ppt QoQ to 14.8%. Average rents for the overall market fell 0.2% in Q1/2019 to an average of RMB204.8 per sq m per month.

TABLE 2: Key Investment Deals, Q1/2019

	45% OF ASCENDAS PLAZA	45% OF ASCENDAS INNOVATION PLACE	LCMETROPOLIS	PUDONG FINANCIAL SQUARE BUILDING 2	YIFANG TOWER
Location	333 Tianyaoqiao Road, Xuhui	686 Jiujiang Road, Huangpu	2389 Zhangyang Road, Pudong	447 North Nanquan Road, Pudong	359 East Changzhi Road, Hongkou
Property type	Office	Office	Office	Office	Office & Retail
Transacted price (RMB mil)	1,100		1,224	1,224	4,600
Sellable GFA (sq m)	24,883	44,000	21,110	49,035	74,342 (retail: 26,898)
Seller	Ascendas-Singbridge	Ascendas-Singbridge	CIFI Group/Hong Kong Land	Lujiazui Properties	Yifang Group
Purchaser	Mitsui & Co	Mitsui & Co	GLP Capital	Ant Finance & Alipay Co.	Keppel Capital
Deal structure	Offshore equity	Offshore equity	Asset	Asset	Asset

Source Savills Research

INVESTOR SENTIMENT

Although investors remain interested in serviced apartments, there are a limited number of opportunities available for en-bloc sales. The government continues to show support for the development of the for-leasing sector by favouring for-leasing projects in land sales and working to establish rental-friendly regulatory and financing conditions. As a result, investors remain interested in the sector. Currently, there are three main strategies for tackling the market, including buying and developing for-leasing-only land, project conversions, and individual units. Each has its unique strengths and weaknesses. The market continues to see new financing methods, such as Asset-backed Securities (ABS), being used to fund projects as capital requirements and long timelines could be challenging for the sector.

DEALS

The market saw continued growth in the for-leasing sector due to a growing amount of capital injection. US multi-family developer and operator Greystar and its JV partner Macquarie Group reached a US450 million first close of its Asia rental housing fund and was said to close its first purchase of a property located within Shanghai's inner ring road with an intention to reposition it as a rental property.

INDUSTRIAL MARKET

Backed by the rapid growth of e-commerce and the huge potential of the domestic consumer base, the market has seen a constant demand for high-quality modern logistics facilities and services. This rising demand, together with the tight supply in first and second-tier cities, has resulted in steady rental growth for logistics properties. Faced with stiff competition, logistics owners are striving to take advantage of high-technology to increase efficiency and achieve higher profit margins. However, as the sector matures, it is expected that yields will have limited room to be further compressed.

Shanghai has been striving to develop into an advanced manufacturing centre in response to the government's Made in China 2025 initiative. Demand is on the rise for manufacturing centres that combine multiple functions under one roof, such as manufacturing, R&D and logistics.

Data centres have experienced a surge in demand as China continues to be one of the world's leading countries for cloud services, big data and cybersecurity. The strong underlying fundamentals of data centres—higher yields and typically longer lease terms—are motivating asset owners to redevelop existing properties into data centres. However, the heavy capital expenditure needed to set up the facilities, which require longer investment timelines and face ongoing regulatory hurdles, might be issues for some short-term funds.

INVESTOR SENTIMENT

The industrial market is dominated by a handful of players, such as GLP and ESR, who are responsible for most of the investment deals. These players typically look for acquisitions of individual assets and developments while PE funds look for big platform investments. Investors are also looking for opportunities to acquire more advanced assets, such as cold chain, which come with entry barriers for other investors. Properties located in the satellite cities of Shanghai are very popular among investors.

LAND MARKET

Total primary land sale consideration reached RMB33.5 billion in Q1/2019, up by 50% YoY. Commodity residential and commercial sectors accounted for 55% and 39%, respectively, of total sales. Residential for-sale and residential for-lease AVs averaged RMB19,900 per sq m and RMB5,500 per sq m, respectively. Commercial AVs averaged RMB15,300 per sq m. Most of the land was transacted at reserved pricing.

As land supply in core areas was limited, the market experienced a rise in investors' interest in adding prime land parcels from the second-hand market to their land banks. In Q1/2019, Greenland purchased a 50% stake in Dongjiadu development site from China Minsheng Investment Group for RMB12 bn, and Sunac acquired two sites from Oceanwide—one in Beijing and the other in Dongjiadu area—for a combined value of RMB12.53 bn. Both land parcels are in core areas in the south Huangpu Bingjiang submarket and both are for residential and commercial use.

OUTLOOK

The credit market is expected to remain stable in the first half of the year as the government looks to maintain economic growth while not reversing the progress they have made in improving financial stability and controlling debt expansion, though many analysts hope and expect financial stimulus.

The overall investment market is expected to heat up in 2019 as assets become more "affordable" and more properties become available, owing to some owners deciding to sell buildings to improve their financial standing.

As more capital is injected in to the multi-family or for-lease residential market, this relatively niche sector is expected to maintain its momentum in 2019. More regulations could be on the cards as this market matures.

TABLE 4: Key Land Deals, Q1/2019

PLOT	DISTRICT	USE	GFA (SQ M)	CONSIDERATION (RMB)	AV (RMB PER SQ M)	BUYER
Nanxi 115-12	Jing'an	Commercial	88,965	5,802	65,216	China Resources, CITIC Group, Wande
Zhongshan a16-02	Putuo	Residential	76,507	3,979	52,008	China Overseas Estate
Chengnan c04-12, c04-13,c04-14	Pudong	Residential	122,815	2,945	23,981	Lujiazui Properties
Jinhui zhen	Fengxian	Residential	123,305	1,849	15,000	Yuzhou Group
Baoshan Industrial Park 111-03	Baoshan	Residential	135,663	1,650	12,165	Shanghai Zhongjian Baju
Gucun 0423-01	Baoshan	Residential	64,260	1,542	24,000	Shanghai Industrial Development

Source Savills Research